No. 91-615 (21)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED-SIGNAL, INC., as successor-in-interest to THE BENDIX CORPORATION,

Petitioner,

v.

DIRECTOR, Division of Taxation,

Respondent.

On Writ of Certiorari to the Supreme Court Of the State of New Jersey

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BRIEF OF *AMICI CURIAE* IN SUPPORT OF PETITIONER BY AMERICAN HOME PRODUCTS CORPORATION, ASARCO INCORPORATED, AVON PRODUCTS, INC., COLGATE-PALMOLIVE CORPORATION, GENERAL MILLS, INC., GEORGIA-PACIFIC CORPORATION, HOUSEHOLD INTERNATIONAL, INC., ICI AMERICAS INC., JAMES RIVER CORPORATION OF VIRGINIA, THE MEAD CORPORATION, NCR CORPORATION, PHILLIPS PETROLEUM COMPANY, PREMARK INTERNATIONAL, INC., RJR NABISCO HOLDINGS CORPORATION, SAFEWAY INC., SCOTT PAPER COMPANY, AND SQUARE D COMPANY

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QUESTIONS PRESENTED

1. Should the Court overrule *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If *ASARCO* and *Woolworth* were overruled, what constitutional principles should govern state taxation of corporations doing business in several states?

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INTRODUCTORY STATEMENT

This brief is submitted by *amici curiae* ("*amici*") in support of petitioner in the above-captioned case. Written con-

sents of the petitioner and respondent have been obtained and are filed with the Clerk of the Court.

INTEREST OF *AMICI CURIAE*

Amici are domestic corporations engaged in business, either directly or indirectly through subsidiaries, throughout the United States and in foreign countries. As such, their business income is subject to apportionment and taxation by non-domiciliary States.

Amici receive intangible income, including dividends, interest, royalties, and capital gains. The fact patterns giving rise to their receipt of intangible income vary. Where *amici* conduct their business activities in multi-corporate form, they commonly receive intangible income in connection with their unitary subsidiaries. In addition, *amici* commonly make investments, including, in some cases, equity investments in unrelated corporations whose activities are functionally unrelated to the unitary business operations of *amici*.

In view of the foregoing, *amici* are concerned about the apportionment and taxation of their intangible income by non-domiciliary States. If *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982), were overruled, *amici* are concerned that *all* of their intangible income would be apportionable by non-domiciliary States. In addition, *amici* are concerned about the apportionment formulas used by non-domiciliary States to apportion intangible income. Finally, *amici* are concerned about the duplicative taxation by domiciliary and non-domiciliary States that could result from inconsistent allocation and apportionment standards.

SUMMARY OF ARGUMENT

New Jersey's position in this case has ramifications far beyond merely overruling *ASARCO* and *Woolworth*. New Jersey effectively asks the Court to destroy the long-standing "unitary business principle" established by the Court

to effectuate the Due Process and Commerce Clause requirement that States only tax a non-domiciliary corporation on income that is fairly related to the corporation's activities in the taxing State. New Jersey's definition of a unitary business would allow a non-domiciliary State to apportion *all* income received by the corporation, regardless of whether the income has any relation to the corporation's activities in the State, thereby allowing the State to tax extraterritorial values.

Rather than adopt New Jersey's unitary business definition, the Court should reaffirm a unitary business test that turns on whether the activities giving rise to the income in issue are related to the taxpayer's activities in the taxing State. Under such a test, as the Court recognized in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), *ASARCO*, and *Woolworth*, intangible income attributable to a taxpayer's equity investment in the underlying business of another corporation generally would not be apportionable if that underlying business were unrelated to the taxpayer's activities in the taxing State. Application of the unitary business test would require a different factual inquiry when other types of intangible income are in issue.

If *ASARCO* and *Woolworth* were overruled, it will be even more important for the Court to clarify that apportionment of intangible income will not meet Due Process and Commerce Clause standards where, as here, the intangible income and the apportionment factors used to apportion that income are conceptually incommensurate. In this case, the intangible income (the capital gain) was attributable to an equity investment in the underlying business of *ASARCO*, but the apportionment factors in the formula reflected only Bendix' separate payroll, property, and sales, and did not reflect ASARCO's factors that gave rise to the intangible income. The Court should make clear that, regardless of the amount of distortion created, such apportionment formulas are "inherently arbitrary", *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920), and will be invalidated if not modified. The Court also should confirm that the apportionment formulas must be modified

to reflect the factors giving rise to other types of intangible income. Consequently, New Jersey's unitary business test would increase, not reduce, administrative complexity since more intangible income would become apportionable and, as a result, there would be more instances requiring modification of the apportionment formula.

Finally, if *ASARCO* and *Woolworth* were overruled, the Court should clarify that the same intangible income cannot be both allocated to the State of commercial domicile (as "non-business income") and apportioned by non-domiciliary States (as unitary business income). Similarly, the Court should provide guidance to avoid duplicative taxation of business income as a consequence of inconsistent unitary business tests.

This *amicus* brief does not address the Court's second question concerning retroactivity.

ARGUMENT

I. THE COURT SHOULD NOT OVERRULE *ASARCO* AND *WOOLWORTH* BECAUSE, IN ASKING THE COURT TO DO SO, NEW JERSEY EFFECTIVELY ASKS THE COURT TO DESTROY THE "UNITARY BUSINESS PRINCIPLE" AND TO ESTABLISH A NEW RULE THAT WOULD ALLOW A TAXING STATE TO APPORTION *ALL* INCOME RECEIVED BY A NON-DOMICILIARY CORPORATION DOING BUSINESS WITHIN ITS BORDERS.

When the Court ordered supplemental briefs addressing the question whether the Court should overrule *Asarco Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982) ("*ASARCO*"), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982) ("*Woolworth*"), it did not ask whether the "unitary business principle" should be overruled. However, that is what New Jersey effectively asks the Court to do. The implications of New Jersey's position go far beyond just the *ASARCO* and *Woolworth* decisions. New Jersey's position in this case would effectively destroy the long-standing "unitary business principle."

A. The "Unitary Business Principle" Gives Effect to the Due Process and Commerce Clause Requirement That a Taxing State May Only Tax a Non-Domiciliary Corporation on the Portion of Its Income That Is Fairly Attributable to Its Activities Within the State.

"[T]he linchpin of apportionability in the field of state income taxation is the unitary-business principle." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980) ("*Mobil*"). Furthermore, the "unitary business principle" has been the "linchpin" of apportionability in an unbroken, consistent line of decisions of this Court going back over more than 70 years.[1]

There is an important reason for the development of the unitary business principle. In cases where a State seeks to tax income of a non-domiciliary corporation[2] that conducts business both within and without the State, the unitary business principle gives effect to the Due Process and Commerce Clause requirement that the State's taxing scheme "reach only the profits earned within the state." *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 133 (1931), quoting *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

When a business' in-state activities and out-of-state activities are sufficiently integrated so that the income from the in-state activities cannot be accounted for or determined separately from the income from the out-of-state activities (*i.e.*, when "the intrastate and extrastate activities form[ed] part of a single unitary business", *Mobil*, 445 U.S. at 438),

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[1] *See*, cases cited in *ASARCO*, 458 U.S. at 320, n.14. Since the *ASARCO* decision, the Court has continued to affirm the unitary business principle. *See, e.g., Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983), and *Trinova Corp. v. Michigan Treas. Dept.*, 498 U.S. ____, 112 L.Ed. 2d 884 (1991).

[2] As used hereinafter, the term "non-domiciliary corporation" means a corporation that is doing business within the taxing State, but is both organized under the laws of, and has its headquarters or commercial domicile in, some other State.

formulary apportionment has been permitted. As the Court stated in *Mobil* (445 U.S. at 438):

> In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.

Thus, "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders", *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. at 121, the taxing State may use formulary apportionment to measure that portion of the income from the unitary business that is fairly attributable to its in-state activities.

The State still is limited, however, to taxing only the income earned by the in-state activities; that constitutional limitation never changes. As the Court noted in *Wallace v. Hines*, 253 U.S. 66, 69 (1920), "The only reason for allowing a state to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it." Similarly, formulary apportionment "calculates the local tax base" of a multi-jurisdictional unitary business. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 165 (1983) ("*Container*").

In "defining the scope of the 'unitary business'" (*Container*, 463 U.S. at 165), wholly-separate or discrete activities, unrelated to the activities in the taxing State, are not taken into account. For example, in *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897), the Court noted that unity of ownership alone was insufficient to justify apportionment, stating (165 U.S. at 222):

> The same party may own a manufacturing establishment in one state and a store in another, and may make profit by operating the two, but the work of each is separate. The value of the factory in itself is not conditioned on that of the store, or *vice versa*, nor is the value of the goods

> manufactured and sold affected thereby. The connection between the two is merely accidental and growing out of the unity of ownership.

In such a case, where the in-state activities and the out-of-state activities are unrelated, it is inappropriate to take those out-of-state activities into account in measuring the income attributable to the separate activities in the taxing State. As Justice Stevens noted in his dissent in *Mobil* (445 U.S. at 453):

> The justification for using an apportionment formula to measure the in-state earnings of a unitary business is inapplicable to out-of-state earnings from a source that is unconnected to the business conducted within the State.

Thus, the "unitary business principle" assures that inclusion of an item of income in the apportionable income base is permitted *only* where appropriate to measure the taxable income attributable to activities in the taxing State. Otherwise, as the Court noted in *Trinova Corp. v. Michigan Treas. Dept.*, 498 U.S. ___, 112 L.E.2d, 884, 904:

> . . . to allow apportionment where there is no practical or theoretical justification could provide the opportunity for a state to export tax burdens and import tax revenues.

Using the example discussed during oral argument in this case on March 4, 1992, if a taxpayer domiciled in New York operates beauty parlors in New York and New Jersey and a parking lot in California, and if it is assumed that the beauty parlors and the parking lot are not parts of a single unitary business, New Jersey may not include any income from the California parking lot in apportionable income.

Moreover, the decisions in *Mobil*, *ASARCO* and *Woolworth*, are perfectly consistent with all of the Court's prior unitary business cases. *Mobil*, *ASARCO*, and *Woolworth* merely applied accepted unitary business principles where the income in issue was intangible income attributable to

business activities that were owned indirectly through equity interests in separate corporations.[3] Because an equity investment in a corporation's stock represents an indirect interest in the underlying business of the corporation, the *Mobil*, *ASARCO*, and *Woolworth* decisions correctly resolved whether the dividends and other intangible income were apportionable by looking to whether the underlying activities of the separate corporations were unitary with the activities of the taxpayer-recipient corporations in the taxing States. Thus, applying established unitary business principles, the Court held in *Mobil* that dividends received from unitary subsidiaries should be included in apportionable income, stating (445 U.S. at 440-441):

> But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise. Had appellant chosen to operate its foreign subsidiaries as separate divisions of a legally as well as a functionally integrated enterprise, there is little doubt that the income derived from those divisions would meet due process requirements for apportionability. Cf. *General Motors Corp. v. Washington*, 377 U. S. 436, 441 (1964). Transforming the same income into dividends from legally separate entities works no change in the underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of income the parent receives. (Footnote omitted.)

Applying the same principle in *ASARCO* and *Woolworth*, the Court held that the income was not includible in apportionable income because the business activities conducted by the payor-corporations were not part of the taxpayers' unitary businesses. These decisions correctly reflect the *Mobil* principle that the "form of business organization" should not dictate the result. If the profits of a business operated

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[3] *Mobil* only involved dividends. *ASARCO* involved dividends, capital gains, and interest, and *Woolworth* involved dividends and gross-up. *See*, *ASARCO*, 458 U.S. at 330, and *Woolworth*, 458 U.S. at 372.

as a division of the taxpayer are not apportionable, because that business is not part of the taxpayer's unitary business, incorporating the division as a subsidiary should not change the result. Dividends thereafter paid by the subsidiary to the taxpayer, or capital gains realized by the taxpayer on the sale of the subsidiary's stock, should not be apportionable because they are generated by the same underlying business, which is not part of the taxpayer's unitary business. Thus, *ASARCO* and *Woolworth* merely represent the logical application of the unitary business principle in cases involving intangible income from equity interests in unrelated corporations.

As will be seen below, New Jersey's position in this case is inconsistent, not only with the results in *ASARCO* and *Woolworth*, but also with the Court's long-standing unitary business principle. Consequently, New Jersey's attempt to overrule *ASARCO* and *Woolworth* is, effectively, an attempt to do far more than just overrule those cases. As is discussed below, New Jersey seeks to destroy the unitary business principle that is at the very heart of the Due Process and Commerce Clause restrictions prohibiting a State from apportioning income that has no relation to activities conducted in the State.

B. New Jersey's Position Would Destroy the Unitary Business Principle and Allow States to Apportion Income Unrelated to the Taxpayer's In-State Activities.

In asking the Court to overrule *ASARCO* and *Woolworth*, New Jersey seeks to shift the traditional unitary business focus away from how income is earned (*i.e.*, whether the income in issue was earned jointly by both in-state and out-of-state activities operating together as a unit). Under New Jersey's approach, all activities are part of a taxpayer's unitary business if they contribute to the taxpayer's "overall profitability" or "growth." (Br. for Resp. p. 25). Thus, on the facts of this case, New Jersey argued that the ASARCO stock investment furthered Bendix' corporate objectives of

growth and diversification. (Br. for Resp. 25, 28; Tr. 39).[4] Moreover, during oral argument before this Court, counsel for New Jersey also argued that it is not even necessary to demonstrate the actual unitary relationship in each case, stating (Tr. 38):

> MS. HAMILL: Because it seems to me that once it's in the same corporate shell, once it's being managed by the same corporate management, it's being—there have to be flows of value. You have to assume that they're there. We can't delve into these facts in every one of these cases. It's an unworkable proposition.

New Jersey's unitary business test is inconsistent with all of the Court's unitary business decisions and would destroy the unitary business principle. First, New Jersey's test is inconsistent with the historic purpose for the unitary business principle, as discussed in Part A, *supra*. The New Jersey test would permit apportionment of income without regard to whether it was necessary in order to measure the income from activities within the State. Thus, even though the ASARCO gain did not in any way reflect the income earned by Bendix' New Jersey activities, New Jersey would include the gain in apportionable income simply because that gain might be used in the future to expand the unitary business.

The proper focus of the unitary business test should remain on how the income was earned, not whether the income may be reinvested to expand the business *after* it is earned.[5] Income currently earned by the unitary business

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[4] "Tr." references are to the official transcript of the oral argument before this Court on March 4, 1992.

[5] It is important to emphasize that New Jersey's test turns on potential, future benefits to the business. Investing funds for *possible future capital expansion* of a business is far different from holding funds as working capital in the *current operation* of the business. Since working capital is currently employed in the business, there is a sufficient, currently-existing relationship between the temporary investment of the working capital and the in-state activities to justify apportioning the intangible

is apportionable among the jurisdictions in which the business is conducted, regardless of whether that income ultimately may be distributed as a dividend, invested in a separate business, or used to expand the business in only one of those jurisdictions. The future use of the income is irrelevant.

By contrast, simply because a source of funds is used for future capital expansion of the business does not mean it is earned in the business and is apportionable to those jurisdictions where it may be invested.[6] Viewing money as a fungible commodity, *all receipts* (including non-taxable loans) from any source will provide some benefit to all businesses conducted by a single taxpayer, whether those businesses are discrete or unitary under the Court's prior decisions. If this alone were sufficient to make the taxable receipts apportionable, there would be no need to apply the unitary business principle in *any* case—whether it involved operating income (as in the Court's earlier decisions) or intangible income (as in *Mobil, ASARCO*, and *Woolworth*).

As the Court recognized in *ASARCO*, relying on such tenuous benefits to define a unitary business (458 U.S. at 326):

> [W]ould destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the

income from that investment. By contrast, there is no such current operational connection or relationship between the investment of funds not yet employed in the business and the in-state activities.

[6] Basing the test on the intended use of the funds also is unworkable since intentions may change. For example, in this case, some of the ASARCO gain was used to retire Bendix' outstanding stock, rather than to expand the business. (J.A. 183).

> "unitary business" limitation becomes no limitation at all.

If income is unitary whenever it may potentially be used in a taxpayer's business, then all income is apportionable. If New Jersey's unitary business test were adopted, there could never be a separate or discrete business activity. The California parking lot, discussed *supra*, was assumed to be non-unitary. But, under New Jersey's test, it always would be unitary with the New York and New Jersey beauty parlors because the income from the parking lot could potentially be used in the beauty parlor business.[7]

Finally, absent any functional relationship, the mere fact that the ASARCO stock diversified Bendix' core businesses cannot make the income unitary. It would be perverse indeed to justify unitary treatment of two separate and discrete businesses on the basis that those businesses are different.

The irreconcilable conflict between New Jersey's view of the unitary business relationship and the prior decisions of this Court setting forth the unitary business principle was clearly revealed during the prior oral argument (Tr. 31-33):

> QUESTION: I guess I don't know what you mean by a unitary business. I guess—is every business that's owned by the same company part of a unitary business?
>
> MS HAMILL: Yes.[8]
>
> QUESTION: Is that the only condition?
>
> MS. HAMILL: Yes. We would say because—

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[7] Nor, for the reasons discussed, *supra*, would there be any merit to New Jersey's position if it were to argue that its position only applies to intangible income and not to income earned from operation of the parking lot directly. Under *Mobil*, the corporate form chosen for operating the California parking lot should make no difference.

[8] This answer by itself shows that more is at stake than just the decisions in *ASARCO* and *Woolworth*. This answer is in conflict with this Court's decision in *Adams Express Co.*, in which the Court noted that ownership alone was not sufficient to justify apportionment.

QUESTION: So there's really no inquiry to be made at all.

MS. HAMILL: That's—yes—

QUESTION: So long as it's owned by the same corporation.

MS. HAMILL: Yes, that's right. . .

Nor is this an isolated case. The destruction of the unitary business principle under New Jersey's approach also is illustrated by the position New Jersey argued unsuccessfully in other cases. *See, e.g., International Paper Co. v. Director, Div. of Taxation,* 11 N.J. Tax 147, 164 (1990), *aff'd.,* N.J. Super. Ct. App. Div., No. A-5138-89T5 (May 13, 1991), *certif. denied,* N.J. Super. Ct., No. 33,784 (Oct. 18, 1991) (New Jersey argued that International Paper's gain on its sale of a minority stock interest was unitary income because the stock was "capable of being pledged, liquidated, or converted to other uses."); *American Home Products Corp. v. Director, Div. of Taxation,* 11 N.J. Tax 287, 302, 304, 307 (1990), appeal docketed, No. A-4316-90T3 (N.J. Super. Ct. App. Div., May 2, 1991) (New Jersey argued that American Home Product's dividends and capital gain from minority stock interests, and its interest income, were unitary business income, citing as support for its position, the commingling of the investment income with general operational funds).

In *ASARCO* and *Woolworth,* this Court rejected the approach New Jersey takes here because that approach would destroy the unitary business principle, which effectuates the long-standing Due Process and Commerce Clause restraint on state taxation of non-domiciliary corporations. The Court should reject New Jersey's approach in this case for the same reason.

C. Rather Than Destroy the Unitary Business Principle as New Jersey Seeks To Do, This Court Should Reaffirm That the Unitary Business Principle Requires, in Each Case, a Factual Analysis of the Relationship Between the Activities Giving Rise To the Intangible Income and the Taxpayer's Activities in the Taxing State.

In determining whether the income in issue in a particular case is apportionable, the Court should preserve a unitary business test that turns on how the income is earned. The Court should clarify that income is apportionable only where the activities giving rise to the income are part of the same unitary business that includes the taxpayer's activities in the taxing State.

This is an inherently factual test and turns on far more than mere ownership or the fact that the income ultimately may be invested in the business *after* the income has been received. For example, where the manufacturing activities and the store discussed in *Adams Express Co.*, 165 U.S. 194, were unrelated, they were not considered to be parts of the same unitary business despite the fact that they were both owned by the taxpayer. By comparison, where operations are functionally integrated, there would be a single unitary business. *See, e.g.*, *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980) (integrated petroleum business); *Bass, Ratcliff & Gretton v. State Tax Commission*, 266 U.S. 271 (1924) (integrated manufacture and sale of ale).

In determining whether the activities giving rise to intangible income are part of the unitary business, the application of the test should turn, among other things, on the type of intangible income in issue. Where, as in *Mobil*, *ASARCO*, *Woolworth*, and the instant case, the income is attributable to an equity investment in the underlying business of another corporation, the test should turn generally on the relationship between the underlying activities of that

corporation and the taxpayer's activities in the taxing State.[9] After all, the equity investment represents an indirect ownership of those underlying activities, and the amount of the income turns on the success of those activities. Any other test would exalt form over substance.

Presumably, a different factual inquiry would be made with respect to other types of intangible income, such as royalties and interest. Where the royalties and interest are received from unitary subsidiaries, the unitary business test would be satisfied.[10] *Amici* recognize that royalties and interest also may be apportionable even if received from unrelated third parties, as long as the activities giving rise to the royalties and interest are part of the taxpayer's unitary business (*e.g.*, royalties from licensing intangibles developed in the business or interest earned from the temporary investment of working capital held for use in the business).

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[9] *ASARCO* and *Woolworth* have been criticized as looking solely to the underlying activities of the payor corporations. *Amici* do not contend that this general rule should apply in every equity investment case. For example, a broker-dealer who holds shares of stock as inventory for sale to customers in the ordinary course of its business may not look for its income to the underlying activities of the corporations whose stock it buys and sells. Like any other dealer, the income will be earned from selling the inventory to the customers.

But such cases are distinguishable, and have nothing to do with the instant case. In this case, Bendix intended to invest in and acquire an indirect ownership of the underlying business of ASARCO and was looking to the success of ASARCO's business (particularly an anticipated increase in the value of ASARCO's copper deposits) for a return on its investment. (J.A. 98-101, 123-125, 241). There was *no* operational connection between the investment and Bendix' separate activities.

[10] If foreign unitary subsidiaries are involved, there may be other constitutional objections arising under the Foreign Commerce Clause to including dividends, interest, or royalties in apportionable income. *See, e.g.*, the issues raised in *Kraft General Foods, Inc. v. Iowa Dept. of Rev. and Fin.*, 465 N.W.2d 664 (Iowa 1991), *petition for cert. filed* (No. 90-1918), which is currently pending before the Court. Other Foreign Commerce Clause issues have been raised in other cases. But, for purposes of this case, the unitary business test would be satisfied, and it would not be a basis for excluding the income from apportionable income.

By the same token, as in *American Home Products Corp.*, 11 N.J. Tax 287, it also is possible, based on the facts of the particular case, that interest income may be attributable to investment activities totally unrelated to the taxpayer's unitary business activities in the taxing State. Interest income was unrelated in *American Home Products*, because the investment portfolio involved greatly exceeded the working capital needs of the business and the activities with respect to the portfolio were conducted entirely outside the taxing state.

Accordingly, in view of the foregoing, *amici* urge the Court to reaffirm the unitary business principle established in *ASARCO*, *Woolworth*, and *all* of its other unitary business cases.

II. IN THOSE CASES WHERE A NON-DOMICILIARY STATE IS PERMITTED TO APPORTION INTANGIBLE INCOME RESULTING FROM AN EQUITY INVESTMENT IN THE UNDERLYING BUSINESS OF ANOTHER CORPORATION, THE COURT SHOULD CLARIFY THAT IT IS UNCONSTITUTIONAL FOR THE STATE TO DO SO BASED ON THE STANDARD, THREE-FACTOR FORMULA, WHICH TAKES INTO ACCOUNT ONLY THE TAXPAYER'S SEPARATE PAYROLL, PROPERTY, AND SALES AND DOES NOT REFLECT THE FACTORS OF THE UNDERLYING BUSINESS THAT GAVE RISE TO THE INTANGIBLE INCOME.[11]

In judging whether a taxpayer's apportionable income is

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[11] Question 3 posed by the Court requested a discussion of the constitutional principles that should govern state taxation of corporations doing business in several states if *ASARCO* and *Woolworth* were overruled. Part II is of great importance to *amici* even if *ASARCO* and *Woolworth* are not overruled, since the apportionment of intangible income received from admittedly unitary subsidiaries is a very significant problem and has spawned a significant amount of litigation. If *ASARCO* and *Woolworth* were overruled, this problem would simply be exacerbated.

Nor are apportionment issues limited to just the apportionment of intangible income attributable to equity investments as is involved in this

"fairly apportioned" *(Complete Auto Transit Inc. v. Brady*, 430 U.S. 274, 279 (1977)), to the taxpayer's in-state activities, this Court set forth the applicable test in *Container*, as follows (463 U.S. at 169-170):

> [A]n apportionment formula must, under both the Due Process and Commerce Clauses, be fair [Citations omitted.] The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation of some income that did not have its source in the taxing State . . . ." [Citations omitted.] Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,' [citation omitted] or has 'led to a grossly distorted result.'" [Citation omitted.] (Emphasis added by Court.)

New Jersey's apportionment formula flunks this test with respect to intangible income from an equity investment in the underlying business of another corporation, because the apportionable income base and the apportionment factors

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case. *See, e.g., NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989) (State taxed a share of dividends, interest, and royalties received from foreign unitary subsidiaries), and *American Home Products Corporation v. Director, Div. of Taxation*, 11 N.J. Tax 287 (1990) (State attempted to tax a share of investment income attributable to an investment portfolio). In both cases, the States refused to modify their formulas to account for the nature of the intangible income in issue.

used to apportion that base are conceptually incommensurate. For example, the base in this case includes approximately $211,500,000 of gain resulting from Bendix' investment in the underlying business of ASARCO (J.A. 6), whereas the apportionment factors are limited to only Bendix' separate payroll, property, and sales. The property, payroll, and sales of ASARCO that increased the value of its stock and gave rise to the gain New Jersey seeks to tax are not reflected in the factors.[12] Thus, whereas the record shows that the investment was made in large part because of Bendix' desire to acquire an interest in ASARCO's copper deposits (J.A. 98-101, 123-125, 241), the value of ASARCO's copper deposits, which were located outside of New Jersey (J.A. 164), is not reflected in Bendix' separate property factor.

Under these circumstances, the factors used in the formula (*i.e.*, Bendix' separate factors) clearly do not "reflect a reasonable sense of how [the capital gain was] generated," as required by the *Container* test. Nor, if the ASARCO capital gain is apportionable, do Bendix' separate factors alone properly "reflect the relative contribution of the activities in the various states [in this case, New Jersey] to the production of the total unitary income." *Butler Bros. v. McColgan*, 315 U.S. 501, 509 (1942).[13] Justice Stevens

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[12] Bendix' capital gain was included by New Jersey in the denominator of the sales factor, but that gain is conceptually far different from ASARCO's underlying gross receipts or sales. (J.A. 205). Moreover, there was no adjustment to the payroll or property factors. Such an adjustment to the sales factor alone is completely inadequate to reflect the payroll, property, and sales that gave rise to the income (*i.e.*, the capital gain) being apportioned.

[13] Apportioning intangible income in this fashion also is inconsistent with the principle in *Mobil* that the form of the taxpayer's corporate organization should not dictate the result. 445 U.S. at 441. If International Paper's Canadian operations had been conducted as a division, the Canadian factors would have been taken into account. In either case, the income attributable to International Paper's activities in New Jersey should be the same.

recognized the inherent unconstitutionality of such a situation in his dissent in *Mobil*,[14] noting (445 U.S. at 459, 461):

> [I]t is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income.
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> * * *
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> Unless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.

This case is a dramatic example. Bendix initially apportioned $56,835,028 of operating income on its state tax return. (J.A. 202). The State added $267,351,914 of capital gain and interest income (including the ASARCO gain of $211,513,354 in issue here) to the apportionable income base. As a result of the ASARCO stock sale alone, apportionable income was increased from approximately $57 million to approximately $268 million, almost a five-fold increase. This increased amount should not be apportioned to New Jersey on the basis of the factors used to apportion Bendix' separate operating income. Bendix' operations in New Jersey consisted primarily of its aerospace activities in Teterboro, New Jersey and the manufacture of electric power generating systems at Eatontown, New Jersey. (J.A. 161-163). Under the State's formula, ASARCO's copper deposits caused these aerospace and manufacturing activities to be treated as being very profitable indeed.

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[14] This question of fair apportionment was identified but left unresolved by the Court in *Mobil* because the issue had not been raised. *Mobil*, 445 U.S. at 434, 441, n.15, and 449. Justice Stevens, in his dissenting opinion in *Mobil* (445 U.S. at 449-462), addressed the merits of this issue.

This case makes it is plain that a formula such as New Jersey's is conceptually flawed (because of the conceptual inconsistency between the apportionable tax base and the apportionment factors) and inevitably taxes income not earned by the taxpayer's in-state activities. Consequently, the formula is never "fair" under the constitutional test of *Container*.

Nor is this case in any way atypical. *Amici* routinely are confronted with such overreaching by the States. *See also, International Paper Co.*, 11 N.J. Tax 147 (1990); *Pledger v. Illinois Tool Works, Inc.*, 812 S.W.2d 101 (Ark. 1991), *cert. denied*, ___ U.S. ___ (1991); and *Corning Glass Works v. Va. Dept. of Tax.*, 402 S.E.2d 35 (Va. 1991) *cert. denied*, ___ U.S. ___ (1991), all involving attempts by the States to apportion, on the basis of the taxpayers' separate apportionment factors, substantial amounts of capital gains from equity investments in the businesses of other corporations. *International Paper* is a particularly egregious example. In *International Paper*, New Jersey succeeded in including in apportionable income over $500 million of capital gain from the sale of a Canadian subsidiary, while successfully excluding from the apportionment formula all of the underlying Canadian factors that gave rise to the gain.

Some state court decisions have recognized the States' overreaching in these circumstances. For example, in *Tambrands, Inc. v. State Tax Assessor*, 595 A.2d 1039 (Me. 1991), Maine sought to include dividends from foreign unitary subsidiaries in apportionable income without also including the associated payroll, property, and sales of the subsidiaries in the apportionment factors. The court concluded that this approach was unconstitutional, stating (595 A.2d at 1044):

> The ineluctable result is that more of the business activity of the unitary business is attributed to Maine than is the actual case. Thus, the income taxable by Maine under the Assessor's formula does not truly reflect Tambrands' connection with Maine and fails to meet the test of fairness required by the due process clause.

See also, NCR Corp. v. South Carolina Tax Com'n, 402 S.E.2d 666 (S.C. 1991) (involving royalties and interest from unitary subsidiaries); *Amer. Tel. & Tel. v. Dept. of Revenue,* 143 Wis.2d 533, 422 N.W.2d 629, 636 (Wis. Ct. App. 1988), (involving dividends from unitary subsidiaries); *NCR Corp. v. Comptroller,* 313 Md. 118, 544 A.2d 764 (1988), (involving dividends and royalties from unitary subsidiaries); and *Hom-art Dev. Co. v. Norberg,* 529 A.2d 115 (R.I. 1987) (involving distributive share of income from a partnership).

Notwithstanding these decisions, the practical reality confronted by *amici* is that the state taxing authorities are intransigent in their efforts to exploit these unfair formulas. For example, at the oral argument in this case, counsel for New Jersey acknowledged that (Tr. 48) "one problem with the three factor formula as it now works is that it doesn't include intangible property at all." Nonetheless, counsel justified excluding the intangible property in this case from the formula because (Tr. 48):

> It was not big enough to create much difference in New Jersey in this tax year, but in some years it can.[15]

In addition, counsel rejected Justice Stevens' statement in his dissent in *Mobil* that the payroll, property, and sales of the dividend-paying corporation should be included in the factors when dividends are included in the apportionable base. (Tr. 48). Similarly, in an *amicus* brief filed by 20 States in support of Virginia's petition for *certiorari* in *Corning Glass Works*, the States acknowledged (p. 12, n.6) Justice Stevens' suggestion for factor modification with respect to dividends, but said factor modification should not

[15] This apparent concession by counsel that modification of the formula would be warranted in some circumstances is of no solace to *amici*. Although New Jersey's statute permits such exercise of discretion (N.J.S.A. 54:10A-8), the State's practice in this regard is demonstrated by its failure to do so in the instant case, *International Paper*, and *American Home Products*. Modification of the formula clearly was warranted in the instant case and in *International Paper* and would have been warranted in *American Home Products* if the court had held the investment income at issue to be apportionable.

be required in *Corning Glass Works* since that case involved capital gains.

A complete response to these points by counsel for New Jersey and the *amici* States in *Corning Glass Works* is beyond the scope of this brief. Three brief points, however, are warranted to show the need for this Court's ultimate intervention with respect to this issue.

A. The Court Should Clarify That "Gross Distortion" in the Traditional, Quantitative Sense Is Not Required in Order to Show That a Conceptually Flawed Formula is Unconstitutional.

Counsel's comment (Tr. 48) about whether it would "create much difference" if the formula were modified is very significant. States commonly defend conceptually indefensible apportionment of intangible income on the ground that the amount of resulting distortion is within constitutional limits—as purportedly established by the opinions of this Court. *See, e.g., NCR Corp. v. Commissioner of Revenue*, 438 N.W.2d 86 (Minn. 1989), in which the court upheld Minnesota's apportionment of intangible income from foreign unitary subsidiaries without factor modification even though a distortion of 23% was acknowledged. The court did so on quantitative grounds, stating (438 N.W.2d at 93):

> [T]o justify a finding of impermissible external inconsistency, any alleged distortion must be demonstrated to be outside the "substantial margin of error." *Container Corp.*, [citation omitted]

The New Jersey Tax Court took the same quantitative approach in *International Paper*, 11 N.J. at 165-167. Similarly, in this case, petitioner's alternative argument for a modification of the formula was denied. (Pet. App. 22a-24a.)

It is critically important for the Court to address this constitutional distinction between intangible income cases (which involve inherently unfair formulas that do not reflect all of the factors that give rise to the income being apportioned) and prior cases like *Container* and *Hans Rees & Sons* (which involve formulas that do reflect all of the fac-

tors). The defective formulas in the intangible income cases always produce distortion and systematically apportion to the in-state activities income earned by the factors not reflected in the formula. Since such formulas are "inherently arbitrary" (*Underwood Typewriter*, 254 U.S. at 121), they should, without more, be invalidated. There can never be a "rational relationship between the income attributed to the State [by such a formula] and the intrastate values of the enterprise" as required by the Due Process Clause. *Mobil*, 445 U.S. at 437. Nor can such a formula be "fair" or satisfy the internal or external consistency tests enunciated in *Container*, 463 U.S. at 169-170.

In *Hans Rees & Sons*, the Court stated (283 U.S. at 133):

> [W]hen the state has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases.

The Court should now clarify that such proof is unnecessary when the State has adopted a formula that *is* "intrinsically arbitrary."

B. The Court Should Clarify That These Principles Apply to Capital Gains and Other Forms of Intangible Income As Well As to Dividends.

Initially, it should be plain that dividends and capital gains from the sale of stock are conceptually inseparable. Both represent income that is attributable to an equity interest in the underlying business of another corporation (the "underlying business"). Dividends constitute earnings of the underlying business that have been distributed. Capital gains on disposition of the equity interest represent earnings of the underlying business that have not yet been distributed or unrealized appreciation in the value of the assets of that business. In either event, the taxpayer's income is generated by the property, payroll, and sales of the underlying business, not by the taxpayer's separate property, payroll, and sales. In this case, the capital gain resulted from ASARCO's business, including its copper holdings.

Where the equity interest giving rise to the apportionable dividends or capital gain is in a subsidiary corporation whose underlying activities are part of the taxpayer corporation's unitary business (as in *Mobil*), *amici* believe that the apportionment factors should be modified to include an appropriate portion of the subsidiary's payroll, property, and sales. If *ASARCO* and *Woolworth* were overruled so that dividends and capital gains attributable to non-unitary corporations also were apportionable, *amici* recognize that the information necessary to make such a modification may not, as a practical matter, be available. In that event, some alternative approach may be constitutional. But, it still would be unconstitutional to fail to make any modification of the formula whatsoever. Indeed, if no modification were made, that alone would be an independent constitutional basis for excluding the income from the apportionable base. The overriding constitutional principle is that there be a conceptual correlation between the apportionable income and the factors used to apportion that income.

The same principle also applies to other forms of intangible income, although, again, different fact patterns may call for different approaches to modifying the apportionment formula. For example, as recognized by the South Carolina Supreme Court, interest and royalties from foreign unitary subsidiaries also are generated by the payroll, property, and sales of those subsidiaries. *NCR Corp. v. South Carolina Tax Com'n*, 402 S.E.2d at 673-674. The apportionment formula should reflect that fact.

A different approach may be called for if the Court approved apportionment of investment income like that at issue in *American Home Products Corp.*, where substantial intangible investment income, far beyond the working capital needs of the business, was generated by the management of the intangible investments outside the taxing State.

C. In View of the Foregoing, Overruling ASARCO and Woolworth Would Entail More Administrative Complexity, Not Less.

During the oral argument (as discussed *infra* at p. 28),

counsel for New Jersey justified the State's unitary business test, in part, on the ground that it would simplify the administrative process and reduce the factual development currently required to determine whether there is a unitary business. As the foregoing demonstrates, New Jersey's position would increase administrative burdens.

If more intangible income were apportionable, there would be a correspondingly increased need to modify the State's apportionment factors. Furthermore, in view of Parts IIA and IIB, *supra*, States should not be able to avoid such modification by contending that the resulting distortion was not too great, or that modification only is required with respect to dividends.

Finally, as discussed *supra*, the appropriate modification in each case would turn on an analysis of the facts in that case. If the intangible income were received from unitary subsidiaries (as determined under traditional unitary concepts), the modification should take into account an appropriate portion of the subsidiaries' payroll, property, and sales. Thus, it still would be necessary to make the unitary business inquiry that New Jersey seeks to avoid. If other types of intangible income were involved, still other factual inquiries would be called for.

III. IF *ASARCO* AND *WOOLWORTH* WERE OVERRULED, THE COURT SHOULD CLARIFY THE PRINCIPLES NECESSARY TO AVOID DUPLICATIVE STATE TAXATION.

During oral argument, counsel for New Jersey was questioned about duplicative taxation if *ASARCO* and *Woolworth* were overruled. (Tr. 41-44). There are two aspects to this concern. First, insofar as New Jersey's position destroys the unitary business principle and, consequently, the concept of "non-business" income, there is the question of duplicative taxation of intangible income of the type that traditionally has been treated as non-business income. The State of commercial domicile may choose to tax 100 percent

of such income as non-business income,[16] and non-domiciliary States may seek to tax the same income on an apportioned basis. This circumstance (allocation and apportionment of the same income) is a problem that *amici* already have had to confront. If *ASARCO* and *Woolworth* were overruled, the problem could become more severe as the non-domiciliary States expanded their taxing power.

Second, insofar as New Jersey's position destroys the concept of a single corporation engaging in two or more separate unitary businesses, there is also the prospect of New Jersey apportioning to itself income that another State may claim is attributable to the activities of a separate business conducted in its jurisdiction. We consider these two circumstances separately.

A. Duplicative Taxation of "Non-Business" Income.

In theory, both allocation and apportionment of non-business income should not occur. If an item of income truly is earned by the unitary business, it is apportionable and cannot also be allocated as non-business income. The Court considered precisely this issue in *Mobil*. In *Mobil*, the taxpayer objected to Vermont's attempt to apportion the dividends there in issue on the grounds that (1) the dividends were fully allocable to New York, the State of commercial domicile, and (2) the same income could not be taxed on both an apportioned and a fully allocated basis. The Court agreed with the second proposition, stating (445 U.S. at 444-445):

> Taxation by apportionment and taxation by allocation to a single situs are theoretically incom-

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[16] Traditionally, the State of commercial domicile has been permitted to allocate to itself capital gains and losses with respect to intangible personal property, interest, and dividends to the extent they constitute "non-business" income. *See, e.g.*, the Uniform Division of Income for Tax Purposes Act, sections 4, 6(c) and 7. The primary draftsman of UDIPTA explained that these provisions were adopted because they "generally follow the prevailing rules now applied by the several states." Pierce, William J., *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 749 (1957).

> mensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained. See *Standard Oil Co. v. Peck*, 342 U.S. 382, 384 (1952).

Thus, the income may not be apportioned by a non-domiciliary State *if* it is fully allocable to a single state.

Amici also wish to clarify that it is immaterial for this purpose if, as in this case, the State of commercial domicile did not, in fact, allocate all of the income in issue to itself. The taxing jurisdiction of one State does not expand or contract depending on another State's decision to exercise the full extent of its taxing power. The Court also confirmed this point in *Mobil*, stating (445 U.S. at 444):

> We agree with Mobil that the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy.

If the Court were to overrule *ASARCO* and *Woolworth*, the Court should reaffirm that the same income may not be both allocated and apportioned. The Court should clarify that any new standard of unitary income is binding on all States.

But, even that would not fully address the other serious problems presented by New Jersey's position. *Amici* also are concerned about the use by domiciliary and non-domiciliary States of conflicting standards for characterizing income either as "business" or "non-business." At the very least, as discussed above, New Jersey's position constitutes a radical shift towards "business" income—assuming it does not destroy the concept of "non-business" income altogether, as *amici* contend. Domiciliary States can be expected to resist this shift and to rely on existing precedent to the maximum extent possible in continuing to treat income as non-business income.[17] This problem of a consistent

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[17] *Amicus* briefs filed to date in support of New Jersey assume that the concept of non-business income would remain intact. *See*, Brief *Amicus Curiae* of Multistate Tax Commission, p. 29; Brief of *Amicus Curiae* California, *et al.*, pp. 27-28.

definition of "business" and "non-business" income is exacerbated by New Jersey's attempt to bolster its position by invoking the concepts of "presumption" and "administrative convenience."[18] This approach would virtually guarantee double taxation by insuring different standards. Under New Jersey's approach, income would *presumptively* be apportionable as business income by non-domiciliary States. At the same time, domiciliary States could apply a different presumption or legal standard and impose a different burden of proof on taxpayers.

In view of this prospect for increased use of conflicting legal standards for defining "business" and "non-business" income, the Court should be prepared to affirm that, if New Jersey's definition of a business income were accepted and *ASARCO* and *Woolworth* were overruled, the same definition *must* be followed by all States. As indicated, *amici* believe this would radically shift traditional taxing prerogatives from domiciliary to non-domiciliary States. But, at least the prospect of double taxation would be minimized.

It is obvious why New Jersey would readily agree to a rule providing that all intangible income is apportionable and no portion may be allocated as non-business income to any State. New Jersey's statute apportions all income and does not allocate any non-business income to New Jersey. N.J.S.A. §54:10A-4(k); §54:10A-6. At the same time, however, 35 States allocate non-business or investment income. State Tax Guide, Vol. 1, ¶ 10-110 (CCH).

Nor is New Jersey bashful about the consequences of its infringement on the historic taxing jurisdiction of domici-

[18] *See, e.g.*, Tr. 32 (see reference to the need for "237 interrogatories with subparts, 10 depositions, and a document request"); Tr. 34 (". . . but the problem is this line drawing, and how is the Court going to help this situation if every time to find out whether there's a unitary business we have to go through the process we went through here."); Tr. 38 ("You have to assume that [flows of value are] there. We can't delve into these facts in every one of these cases. It's an unworkable proposition."); Tr. 44 ("I think once you've decided that what is in the business is presumptively part of the unitary business Tennessee would have to apportion. Tennessee could not then grab it all.").

liary States. It recognizes the conflict. But, during oral argument, counsel for New Jersey asked why the domiciliary States should be preferred. (Tr. 40). The question misses the point. As this Court clarified in *Mobil*, 445 U.S. at 443-446, there is no preference insofar as the treatment of business income is concerned. But, under the Due Process and Commerce Clauses, non-domiciliary States may only tax income that is attributable to the taxpayer's in-state business activities. Ultimately, that is the constitutional standard that New Jersey must satisfy in taxing non-domiciliary corporations.

In sum, the Court should only overrule *ASARCO* and *Woolworth* if the Court also is willing to alter the historic relationship between domiciliary and non-domiciliary States in order to prevent duplicative taxation of intangible income. If the Court is unwilling to alter that relationship, then it should not overrule those cases since to do so would result in allocation and apportionment of the same income, a result the Court has stated is unacceptable.[19]

B. Duplicative Taxation of Business Income.

The considerations here are essentially the same. Again, counsel for New Jersey forthrightly acknowledged that, under the State's position, all activities of a single corporation would constitute a single unitary business so that no State could treat the profitable activities in its jurisdiction as a separate business fully taxable by that State. Thus, in response to a hypothetical question about a profitable forest business in Tennessee, counsel responded (Tr. 44):

> MS. HAMILL: I think once you've decided that what is in the business is presumptively part of

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[19] Finally, even if the State of commercial domicile agreed to treat the income as apportionable, there is *still* a prospect of double taxation if the States adopt inconsistent apportionment formulas. Understandably, if the corporation's investment activity were deemed to give rise to business income, the State of commercial domicile may want that fact reflected in some meaningful way in the formula. To date, as discussed *supra*, States like New Jersey have been unwilling to modify their formulas.

the unitary business Tennessee would have to apportion. Tennessee could not then grab it all.

Again, *amici* strongly object to New Jersey's radical position that all corporate activities are part of the same unitary business. But, if the Court adopts this position, it should also clarify that it is binding on all States.

CONCLUSION

The Court should not overrule *ASARCO* and *Woolworth.* If *ASARCO* and *Woolworth* were overruled, it will be even more important for the Court (1) to clarify that modification of the apportionment formula is required to reflect the inclusion of intangible income in the apportionable base, and (2) to clarify that all States are bound by the same unitary business test so that duplicative state taxation will be avoided.

Respectfully Submitted,

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